Greater Effects of Hurricanes in Business Interruption Claims

In the classic film *Forrest Gump*, after Forrest returned from the Vietnam War, he honored a wartime promise he had made to his deceased friend Bubba by buying a shrimp boat (that he named *Jenny*), moving to the Bayou, and launching The Bubba Gump Shrimp Company. Although Bubba Gump Shrimp initially struggled to stay afloat (Forrest caught only five shrimp), the company was extremely profitable after Hurricane Carmen decimated every shrimping boat in the region except for Forrest's *Jenny*, and Forrest's competitors thus went out of business. As Forrest explained, "people still needed them shrimps for shrimp cocktails and barbecues and all, and we were the only boat left standing." In addition to being a lucrative twist for Forrest, this scene addresses a scenario that has been the subject of many coverage disputes regarding hurricane-related (or other catastrophe-related) business interruption insurance claims.

Specifically, parties have disputed, and courts have addressed, whether the valuation of a business interruption claim should consider the effects that the hurricane (or other catastrophic event) had on the surrounding region, positive or negative, including its effect on the policyholder's competitors and on the local economy. Some courts have held that the business interruption claim calculation should take into account real-world economic conditions that exist after, and were caused by, the hurricane. In other words, the assumption should be that the hurricane hit but did not damage the policyholder's property. Other courts, by contrast, have held that the business interruption calculation should assume that the hurricane never happened at all and thus should be based on pre-loss sales, projections, and economic conditions.

The same analytical approach can result in a pro-policyholder or a pro-carrier result depending on whether the hurricane or loss event would have either increased or decreased the demand for the policyholder's goods or services. For example, if the hurricane adversely affected the policyholder's competitors, then considering the greater effects of the hurricane could allow a policyholder to recover profits that it would have earned had it, like Bubba Gump Shrimp, been able to continue operating after the hurricane damaged, and interrupted the businesses, of its competitors. By contrast, if the hurricane's effect on the local economy would have resulted in a decreased demand for the policyholder's goods or services, then considering the wider effects of the hurricane could reduce, or negate, a policyholder's business interruption claim.

This article examines the evolution of case law and policy language addressing this issue. In a number of cases beginning in the 1990's and extending beyond Hurricane Katrina, courts' analysis of this issue focused on the interpretation of the following phrase, which appears in most business interruption provisions: "due consideration shall be given to the experience of the business before the Period of Recovery and the probable experience thereafter had no loss occurred" (or words to this effect). In response to these cases, the insurance industry began crafting policy language that addresses circumstances under which the greater (or less great) effects of a hurricane or other peril will be factored into the valuation of a business interruption claim. Different variations of this language exist in the marketplace today. One version of this language was construed by the Fifth Circuit in the context of a Hurricane Katrina claim, and we can expect more such cases in the future.

Cases Construing the “Had No *Loss* Occurred” Policy Language

A number of the cases examining the relevance of post-event economic conditions have addressed the issue in the context of policy language that requires a policyholder’s business interruption loss to be measured as if “no loss had occurred.” The following is an example of the relevant business interruption provision that commonly appears in business interruption insurance provisions:

> In determining the loss hereunder, due consideration shall be given to the earnings of the business before the date of the damage or destruction and to the probable earnings thereafter, had no loss occurred.

As is often the case, various courts have interpreted this language differently.

Cases Declining to Consider the “Greater Effects” of the Storm

Some courts have interpreted this language to require that the policyholder’s loss must be measured as if the triggering event had not happened at all. Hence, courts have held that a policyholder cannot recover for losses that it hypothetically would have earned during the period of recovery had the event or occurrence taken place and caused widespread damage but not damaged the policyholder’s property (*i.e.*, the Bubba Gump Shrimp Company’s experience). For example, in *Prudential LMI Commercial Insurance Co. v. Colleton Enterprises, Inc.*, 976 F.2d 727 (4th Cir. 1992), the policyholder’s Econo Lodge motel was operating at a loss before it was damaged by Hurricane Hugo. The policyholder sought to recover almost $200,000 in lost profits, arguing that it would have earned these profits had it been open for business after the storm due to the influx of temporary residents in need of hotel accommodations after the storm. Prudential denied the claim, arguing that the policyholder’s business interruption claim must be based on its historical profit projections, and that because the Econo Lodge was operating at a loss pre-storm, it was not entitled to recover any business interruption losses.

Although the court noted that the policyholder’s pre-storm losses did not conclusively establish that it would not have been profitable post-storm, it concluded that the “had no loss occurred” policy language reflected an intent to exclude from consideration post-loss economic conditions caused by the same event that caused the policyholder’s property damage. The court reasoned that consideration of post-loss economic conditions caused by Hurricane Hugo would defeat the purpose of business interruption coverage, which it characterized as putting the policyholder “in the earnings position it would have been in had the insured peril not occurred,” and would provide the policyholder with an unintended windfall.

Other courts have adopted this rationale in holding that a policyholder’s business interruption claim should not include amounts that would have been earned as a result of favorable post-loss economic conditions caused by the same event that caused the policyholder’s business interruption loss. In *American Automobile Insurance. Co. v. Fisherman’s Paradise Boats, Inc.*, No. 93-2349CIVGRAHAM, 1994 U.S. Dist. LEXIS 21068, at *6 (S.D. Fla. Oct. 3, 1994) (“*Fisherman’s Paradise*”), the court did not allow the policyholder to recover likely profits that it would have earned had its fisherman’s store not been damaged by Hurricane Andrew and thus been able to “reap the economic benefits of post-hurricane demand for boats and marine accessories.” The court reasoned that “had no hurricane occurred (the policy’s built in premise for assessing profit expectancies during business interruption), [then] neither would the claimed earnings source.” Likewise in *Catlin Syndicate Limited v. Imperial Palace of Mississippi, Inc*., 600 F.3d 511, 513-16 (5th Cir. 2010) (“*Imperial Palace*”), the court held that the policyholder could not recover "what it would have earned had it been able to remain open immediately after Hurricane Katrina, while all of its competitors were closed due to damage from the storm." The court explained that while "loss" and "occurrence" are separate and distinct terms, the two are "inextricably intertwined under the language of the business interruption provision." The court accordingly declined to "interpret the business interruption provision in a way that the loss caused by Hurricane Katrina can be distinguished from Hurricane Katrina itself."

On the flip side of this same coin, courts have likewise held that this same policy language prohibits insurance carriers from relying on post-loss economic conditions caused by the covered peril to reduce a policyholder's business interruption recovery.

For example, in *Consolidated Companies, Inc. v. Lexington Insurance Co.*, 616 F.3d 422 (5th Cir. 2010) ("*Conco*"), Conco was forced to completely suspend its warehouse operations for a ten-day period after Hurricane Katrina damaged its facilities, and then was able to resume only partial operations for another 15 months. The policy required consideration of the probable experience of the business during the period of recovery as if "no loss occurred." Conco's business interruption claim was calculated based on historical earnings data and projections.

Lexington contended that Conco's proof was insufficient to support its lost profits claim. It argued that Conco was entitled to recover only lost profits caused by damage to its facilities, but that Conco's claim also included lost profits caused by the generally poor post-Katrina economic conditions. The court rejected Lexington's assertion that Conco's failure to offer evidence distinguishing these two types of damages should bar its recovery. Relying on, among other things, the *Imperial Palace* court's interpretation of the "had no loss occurred" policy language, the *Conco* court explained that "[t]he jury was not to look at the real-world opportunities for profit post-Katrina, but instead was to decide the amount of money required to place Conco in the same position in which [it] would have been had [Katrina not] occurred." The court further found that "Conco was not required to draw a bright line in its evidence between loss stemming from property damage and loss stemming from market conditions."

Cases Considering the "Greater Effects" of the Storm

On the other hand, at least one court has interpreted "loss" to mean the property damage sustained by the policyholder rather than the event or occurrence that caused the property damage. In *Stamen v. Cigna Property & Casualty Insurance Co*., Case No. 93-1005, 1994 U.S. Dist. LEXIS 21905 (S.D. Fla. June 10, 1994), the policyholder sought to recover lost profits it sustained after many of its convenience stores were damaged by Hurricane Andrew. The policyholder argued that it was entitled to recover profits its stores would have earned had they remained open after the hurricane, whereas the carrier argued that the policy language required that lost profits be calculated as if Hurricane Andrew never took place. The court agreed with the policyholder, holding that the policy required one to "look at [the policyholder's] situation as if each individual . . . store had not been damaged, or had not incurred any loss." The court found that "loss" necessarily must have a different meaning than "occurrence," which clearly referred to the hurricane, and reasoned that if the parties had intended to exclude post-hurricane economic conditions from consideration then the policy's business interruption valuation provisions would have used the term "occurrence" rather than "loss." The court also rejected the insurer's windfall argument, explaining that the policyholder's stores would have reaped greater profits after the hurricane, and that these losses are exactly what the policy is required to cover.

A few other courts, construing different policy language, likewise have allowed policyholders to recover increased revenues or profits that they would have earned during the period of recovery due to more favorable business conditions created by the peril that damaged their property. In *Levitz Furniture Corp. v. Houston Casualty Co*., No. CIV. A. 96-1790, 1997 US Dist. Lexis 5883 (E.D. La. Apr. 28, 1997), the court held that the policyholder, which suffered a flood-caused business interruption loss, was entitled to recover the lost profits it would have earned due to increased consumer demand had it been able to continue its operations after the storm. Unlike the policies at issue in *Colleton Enterprises and Fisherman's Paradise Boats*, however, the *Levitz Furniture* policy expressly allowed for consideration of the "probable experience thereafter . . . had no ***interruption of production or suspension of business operations or services occurred***." (emphasis added). The policy thus "clearly and unambiguously" covered "profit opportunities due to increased consumer demand created by the flood."

Additionally, in *Sher v. Lafayette Insurance Co*., 973 So. 2d 39 (La. Ct. App. 2007), *affirmed in part and reversed in part on other grounds*, 988 So.2d 186 (La. Ct. App. 2008), an apartment building owner's rental units were damaged by, and thus uninhabitable for a period of time after, Hurricane Katrina. The policy at issue covered the "Business Income you sustain due to the necessary suspension of your 'operations' during the 'period of restoration.'" Reasoning that the policy covers "Mr. Sher's 'actual loss' of business income," the court affirmed the jury's award for lost rents that were calculated based on the higher rental rates available in the post-Katrina economic environment.

<u>Policy Language Specifically Addressing Post-Loss Economic Conditions Caused by the Event Triggering Coverage</u>

In response to disputes and case law concerning consideration of the greater effects of a hurricane or other peril on the surrounding area, some business interruption provisions now include language specifically addressing whether post-loss economic conditions should factor into the calculation of the policyholder's business interruption loss. There are different variations of this language. For example, some policies state that the measurement of a business interruption claim shall not take into account "any Net Income that would likely have been earned as a result off an increase in the volume of business due to favorable business conditions caused by the impact of the Covered Cause of Loss on customers or on other businesses."

The Fifth Circuit construed a similar clause in *Berk-Cohen Associates, LLC v. Landmark American Insurance Co*., 433 Fed App'x 268 (5th Cir. 2011), in which the policyholder sought to recover lost rental income after its apartment complex was damaged by Hurricane Katrina (among other things). The policyholder's claim was calculated based on increased rental rates in effect after, and as a result of, Katrina. The parties agreed that Hurricane Katrina had caused a combination of wind damage, which indisputably was covered under the policy, and flood damage, which indisputably was not. Landmark argued that the policyholder's reliance on inflated post-Katrina rental market rates to measure its business interruption loss was not permitted under the policy, which stated that there shall be no consideration of "any Net Income that would likely have been earned as a result of . . . favorable business conditions caused by the impact of the Covered Cause of Loss on customers or on other businesses."

The court rejected Landmark's argument, focusing on the phrase "Covered Cause of Loss." The court held that the policyholder "may not recover for lost business income as a result of wind damage suffered by customers and competing businesses. On the other hand, any increase in customers' demand or reduction in competitors' supply due to flooding at other properties is a permissible factor in calculating lost business income." The court further held that the policy's flood exclusion was inapplicable. It reasoned that that exclusion is relevant only to the determination of whether there is coverage, and because there was no dispute that the policy covered wind damage, "the flood exclusion has nothing further to say. . . . We decline to use a limitation on coverage to alter the calculation of damages for a covered cause of loss." The policyholder thus was permitted to recover additional lost income due to increased rental rates resulting from flooding throughout New Orleans.

Other policies include different variations of "greater effects" language. Some policies state that the "probable experience" of the business during the period of recovery "will consider any increase or decrease in the demand for the policyholder's goods or services" during the recovery period, regardless of whether such increase or decrease is from the same event that caused the physical loss or damage that triggered the business interruption coverage. By contrast, other policies include "heads, I win; tails you lose!" language. These forms on the one hand state that the policyholder cannot recover lost profits that would have been earned due to favorable opportunities or conditions created by the covered peril, but, on the other hand, also state that the carrier is entitled to reduce the business interruption claim to reflect unfavorable economic conditions attributable to the impact that the covered peril had on the surrounding geographic area.

An important take-away from the "greater (or not so great) effects" case law is that the policy language included in business interruption valuation provisions can be determinative. It is important for companies to review this language carefully when buying or renewing their business interruption policies, particularly because different variants of this language exists in the market place. At a minimum, companies should avoid buying policies that allow carriers to reap the benefits of an economic downturn, but not allow policyholders to reap the benefits from a potential uptick in demand for its goods or services, caused by a covered peril.

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